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CITATIONS

489683—42——1

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 419

R. SIMPSON & CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 25–30) in this case is reported in 44 B. T. A. 498. The opinion of the Circuit Court of Appeals (R. 49) is reported in 128 F. (2d) 742.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 6, 1942 (R. 50). The petition for a writ of certiorari was filed on September 25, 1942. Jurisdiction is conferred on this Court under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether taxpayer is a personal holding company within the meaning of Section 351 (b) (1) of the Revenue Acts of 1934 and 1936 and therefore subject to the surtax imposed by paragraph (a) of that section.

2. If so, whether the statute violates the due process clause of the Fifth Amendment of the Constitution.

3. If taxpayer is a personal holding company, whether it is liable for a 25% penalty for failure to file a return on Form 1120–H as required by Article 351–8 of Treasury Regulations 86 and 94, promulgated under the Revenue Acts of 1934 and 1936.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 9–17.

STATEMENT

The facts as found by the Board of Tax Appeals are as follows (R. 26–28):

During the taxable years, 1934–1936, petitioner was actively engaged in the conduct of business with the general public in the operation of its pawn shops. It made loans of money on personal property consisting almost entirely of jewelry. During those years, more than 50% of its capital stock was owned by less than five stockholders, and more than 80% of its gross income was derived from interest (R. 27).

On or before the respective due dates taxpayer filed its complete income and excess profits tax returns on Form 1120 for each of the years. The question asked on each return, whether the reporting corporation was a personal holding company within the meaning of Section 351 of the applicable Revenue Acts, was answered in the negative. The form of return for each of the three years advised the taxpayer that if it was a personal holding company the filing of an additional return on Form 1120-H was required. Taxpayer also filed information returns, Form 1096, with the attached Form 1099 listing the amounts of dividends over $300 paid to its stockholders, for the years in question. Taxpayer's books and records, which gave some indication that more than 50% of its stock was owned by less than five stockholders and disclosed that at least 80% of its income was derived from interest, were at all times available to the Commissioner and were actually made available to the Commissioner's agents during audit of the income tax returns for the taxable years (R. 27-28).

Taxpayer did not file personal holding company returns, Form 1120-H, for the taxable years. Robert C. Simpson, who has been president of taxpayer since 1932 and was its treasurer from 1922 until 1932 and who executed its income-tax returns for the years in question, having personally prepared the returns for two of

the years, was aware of the provisions of Section 351 of the Revenue Acts of 1934 and 1936 and the requirements with respect to the filing of personal holding company returns. He did not file personal holding company returns on behalf of taxpayer for the taxable years because he thought taxpayer was not a personal holding company within the meaning of Section 351 (R. 28).

The Board concluded that (R. 28) during the years 1934, 1935, and 1936 the taxpayer was a personal holding company within the meaning of Section 351 of the applicable Revenue Acts, and approved the imposition of the statutory penalty for failure to file personal holding company returns (R. 30).

The court below affirmed the Board as to the first point, on the authority of *Noteman* v. *Welch*, 108 F. (2d) 206 (C. C. A. 1st); and as to the second, on the authority of *O'Sullivan Rubber Co.* v. *Commissioner*, 120 F. (2d) 845 (C. C. A. 2d) (R. 49).

ARGUMENT

1. The court below correctly decided that the petitioner was a "personal holding company" within the meaning of Section 351 of the Revenue Acts of 1934 and 1936. Since more than 80% of its income consisted of interest, and since more than 50% of its stock was owned by less than five persons, petitioner falls squarely within the statutory definition in Section 351 (b) (1). There are no decisions to the contrary. The decisions

relied upon by petitioner (Pet. 9–10) do not deal with these statutory provisions and thus have no application here.

Petitioner contends that the statute was intended to reach only "incorporated pocketbooks" and not operating companies such as itself. However, it has been uniformly held that the term "personal holding company" is not to be so restricted and that any corporation which complies with the carefully specified criteria in Section 351 (b) (1) is within the statute. *Noteman v. Welch*, 108 F. (2d) 206 (C. C. A. 1st); *Girard Inv. Co. v. Commissioner*, 122 F. (2d) 843 (C. C. A. 3d), certiorari denied, 314 U. S. 699; *Commissioner v. Affiliated Enterprises*, 123 F. (2d) 665 (C. C. A. 10th), certiorari denied, 315 U. S. 812. See also *O'Sullivan Rubber Co. v. Commissioner*, 120 F. (2d) 845 (C. C. A. 2d); *American Package Corp. v. Commissioner*, 125 F. (2d) 413 (C. C. A. 4th). Moreover, it is apparent that Congress realized that its definition would include some operating companies because it took pains specifically to exclude banks, insurance companies, and surety companies.

The argument that a pawnbroker's revenues are not "interest" within the meaning of the statute is based upon the highly technical distinction that a pawnbroker does not hold the pledgor's promise to pay. However, it is conceded (Pet. 14) that the term "interest" has been

applied for centuries to the pawnbroker's charge, and it appears that the taxpayer reported its receipts in its federal income tax returns as "interest on loans" (R. 26). Similar arguments have been rejected in *Noteman* v. *Welch* and *Girard Inv. Co.* v. *Commissioner, supra.*

2. The contention that the statute makes an arbitrary classification is without substance. The tax is upon undistributed income of corporations controlled by a small number of stockholders, where the great bulk of the income is derived from specified sources. Congress was focussing its attention upon corporations that might conveniently be used by its stockholders for avoidance of surtaxes, and the classification which it established was therefore entirely reasonable. The fact that the line is so drawn that some similar corporations will not be reached is constitutionally immaterial. *Klein* v. *Board of Supervisors,* 282 U. S. 19, 23; *Steward Machine Co.* v. *Davis,* 301 U. S. 548, 584. Cf. *West Coast Hotel Co.* v. *Parrish,* 300 U. S. 379, 400. Moreover, it is settled that Congress is not limited to conventional classifications in framing its tax laws (*Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110), and taxes upon special classes of income have been specifically sustained (*United States* v. *Hudson,* 299 U. S. 498). No court has even questioned the validity of the provisions here involved. Although the issue was raised in *Girard*

Ins. Co. v. Commissioner, supra, the court assumed the constitutionality of the statute without discussion. See also *Noteman v. Welch, supra,* and *Foley Securities Corp. v. Commissioner,* 106 F. (2d) 731 (C. C. A. 8th).

3. Petitioner complains of the 25% penalty which was imposed because of its failure to file a separate return on Form 1120–H, as prescribed by Article 351–8 of Regulations 86 and 94 (Appendix, *infra,* pp. 16–17); and it asserts that its failure to file the return involved no attempt at concealment, as evidenced by the facts which it revealed on other returns and by the facts which were available to the Commissioner from its books and records. However, the 25% penalty is mandatory where the taxpayer has not filed the return on Form 1120–H. *O'Sullivan Rubber Co. v. Commissioner,* 120 F. (2d) 845 (C. C. A. 2d) so holds, and there is no decision to the contrary. See also *Lone Pine Lawn Corp. v. Helvering,* 121 F. (2d) 935 (C. C. A. 2d); *Logan Coal & Timber Assn. v. Helvering,* 122 F. (2d) 848 (C. C. A. 3d); *Porto Rico Coal Co. v. Commissioner,* 126 F. (2d) 212 (C. C. A. 2d). See also *Noteman v. Welch, supra.* Cf. *Girard Inv. Co. v. Commissioner, supra.*

As the foregoing cases indicate, the question of reasonable cause for delinquency becomes pertinent only where the return in question is later filed by the taxpayer, which was never done in

this case. In any event, as pointed out by the Board (R. 30), taxpayer's failure to file the required return was due entirely to its erroneous impression that it was not a personal holding company. Such excuse cannot satisfy the requirement of reasonable cause which the statutory exceptions lays down.

CONCLUSION

The decision below is correct. There is no conflict. The petition should be denied.

Respectfully submitted.

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OCTOBER 1942.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 53. TIME AND PLACE FOR FILING RETURNS.

(a) *Time for Filing.*—

(1) *General rule.*—Returns made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year.

(2) *Extension of time.*—The Commissioner may grant a reasonable extension of time for filing returns, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

* * * * *

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this title or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title.

* * * *

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file a return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, 25 per centum of the tax shall be added to the tax, except that when a return is filed after such time and it is shown that the failure to file it was due to reasonable cause and not due to willful neglect no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

* * * * *

SEC. 351. SURTAX ON PERSONAL HOLDING COMPANIES.

(a) *Imposition of Tax.*—There shall be levied, collected, and paid, for each taxable year, upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:

(1) 30 per centum of the amount thereof not in excess of $100,000; plus

(2) 40 per centum of the amount thereof in excess of $100,000.

(b) *Definitions.*—As used in this title—

(1) The term "personal holding company" means any corporation (other than a corporation exempt from taxation under section 101, and other than a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the

receipt of deposits, and other than a life-insurance company or surety company) if—(A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities, and (except in the case of regular dealers in stock or securities) gains from the sale of stock or securities, and (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. * * *

(c) *Administrative Provisions.*—All provisions of law (including penalties) applicable in respect of the taxes imposed by Title I of this Act, shall insofar as not inconsistent with this section, be applicable in respect of the tax imposed by this section, except that the provisions of section 131 of that title shall not be applicable.

* * * * *

Revenue Act of 1935, c. 829, 49 Stat. 1014:

SEC. 406. FAILURE TO FILE RETURNS.

In the case of a failure to make and file an internal-revenue tax return required by law, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, if the last date so prescribed for filing the return is after the date of the enactment of this Act, if a 25 per centum addition to the tax is prescribed by existing law, then there shall be added to the tax, in lieu of such 25 per centum: 5 per centum if the failure is for not more than 30 days, with an additional 5 per centum for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 per centum in the aggregate.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

* * * * *

SEC. 351. SURTAX ON PERSONAL HOLDING COMPANIES.

(a) *Imposition of Tax.*—There shall be levied, collected, and paid, for each taxable year (in addition to the taxes imposed by Title 1), upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:

(1) 8 per centum of the amount thereof not in excess of $2,000; plus

(2) 18 per centum of the amount thereof in excess of $2,000 and not in excess of $100,000; plus

(3) 28 per centum of the amount thereof in excess of $100,000 and not in excess of $500,000; plus

(4) 38 per centum of the amount thereof in excess of $500,000 and not in excess of $1,000,000; plus

(5) 48 per centum of the amount thereof in excess of $1,000,000.

(b) [Contains the same definition as given in Section 351 (b) of the Revenue Act of 1934, *supra*.]

(c) [Contains the same statement as to administrative provisions as given in Section 351 (c) of the Revenue Act of 1934, *supra*.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934:[4]

ART. 291–1. *Addition to the tax in case of failure to file return.*—In case of failure to make and file a return required by Title I within the prescribed time, 25 percent of the amount of the tax is added to the tax unless the return is later filed and failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. Two classes of delinquents are subject to this addition to the tax:

[4] Articles 291–1, 351–1, 351–2, 351–8 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, contain provisions similar to the articles with the same numbers in Regulations 86. Art. 291–1 of Treasury Regulations 86 was amended by T. D. 4626, XV–1 Cum. Bull. 61, 76–77 (1936), but the only material change was with reference to the size of the penalty which was made to accord with the amendment in the Revenue Act of 1935, Sec. 406.

(*a*) Those who do not file returns and for whom returns are made by a collector or the Commissioner, and

(*b*) Those who file tardy returns and are unable to show reasonable cause for the delay.

A taxpayer who files a tardy return and wishes to avoid the addition to the tax must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be attached to the return. If such an affidavit is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and, if the Commissioner determines that the delinquency was due to a reasonable cause and not to willful neglect, the 25 percent addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return in the prescribed time, then the delay is due to reasonable cause.

If the 25 percent addition to the tax for delinquency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

* * * * *

ART. 351–1. *Surtax on personal holding companies.*—Section 351 of Title IA imposes an additional graduated income tax or surtax upon corporations classified as personal holding companies. Corporations so classified are exempt from the surtax on corporations improperly accumulating surplus imposed by section 102 of Title I, but are not exempt from the other taxes imposed by that title. Unlike the surtax im-

posed by section 102, the surtax imposed by section 351 applies to all personal holding companies defined as such in article 351–2 regardless of whether or not they were formed or availed of to accumulate gains and profits for the purpose of avoiding surtax upon shareholders.

ART. 351–2. *Classification of a personal holding company.*—A personal holding company is defined as any corporation (other than a corporation specifically exempt), first, 80 percent or more of whose gross income for the taxable year was derived from royalties, dividends, interest, annuities, and gains from the sale of stock or securities; and, second, more than 50 percent in value of whose outstanding stock was owned, directly or indirectly, at any time during the last half of the taxable year by or for not more than five individuals. The only corporations specifically exempt from this tax are as follows: (1) Corporations exempt from taxation under section 101 of Title I; (2) banks and trust companies (incorporated under the laws of the United States, or of any State or Territory), a substantial part of whose business is the receipt of deposits; (3) life insurance companies; and (4) surety companies.

It is the nature of the gross income and the ownership of the outstanding stock which determine the classification as a personal holding company, and the several conditions with respect to both must be satisfied to bring a corporation within the classification. Gross income must be determined for the entire taxable year and the ownership of the stock outstanding must be determined according to its ownership

at any time during the last half of the taxable year. Inasmuch as such circumstances can vary from year to year, a corporation may constitute a personal holding company for some years and not for other years. In that case, the surtax liability shall be determined under section 351 only for the years in which the corporation comes within the classification as a personal holding company, while the liability for surtax as to the other years will depend upon whether the corporation comes within the provisions of section 102 with respect to such years.

* * * * *

(3) *Interest.*—The term "interest" means any amounts received for the use of borrowed money which are includible in gross income under Title I.

* * * * *

ART. 351–8. *Return and payment of tax.*—A separate return is required for the surtax imposed under section 351. Such return shall be made on Form 1120H. In the case of a personal holding company which is a domestic corporation, the return is required to be made within the time prescribed in section 53 and in the case of a foreign corporation within the time prescribed in section 235. The tax shown by the corporation on its return must be paid in the case of a domestic corporation within the time prescribed in section 56 and in the case of a foreign corporation within the time prescribed in section 236. The same provisions of law relating to the period of limitation for assessment and collection which govern the taxes imposed by Title I also apply to the surtax imposed under Title IA. However, since the surtax im-

posed under Title IA is a distinct and separate tax from those imposed under Title I, the making of a return under Title I will not start the period of limitation for assessment of the surtax imposed under Title IA. If the corporation subject to section 351 fails to make a return, the tax may be assessed at any time. If the Commissioner finds a deficiency in respect of the tax imposed by section 351, he is required to follow the same procedure which applies to deficiencies in income tax under Title I. The penalties applicable to the income taxes imposed under Title I, as well as the provisions of Title I relating to interest and additions to the tax, also apply to the surtax imposed by section 351. The administrative provisions applicable to the surtax imposed by section 351 are not confined to those contained in Title I but embrace all administrative provisions of law which have any application to income taxes.

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